INDEX

CITATIONS

651103—45——1

In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 94

LOUIS HAMBURGER AND SAMUEL HAMBURGER,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 95) is not officially reported. The *per curiam* opinion of the circuit court of appeals is reported at 147 F. 2d 856 (R. 121).

JURISDICTION

The judgment of the circuit court of appeals was entered on March 12, 1945 (R. 121). Petition for a writ of certiorari was filed on May 28, 1945. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the courts below have properly held that the taxpayers are taxable upon the income from certain trusts for the years 1937, 1938, 1939, and 1940 under Section 22 (a) of the Revenue Act of 1936 and the doctrine of *Helvering* v. *Clifford,* 309 U. S. 331.

STATUTES INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Section 22 (a) of the Revenue Act of 1938, c. 289, 52 Stat. 447, applicable to the year 1938, and Section 22 (a) of the Internal Revenue Code (26 U. S. C., Sec. 22 (a)), applicable to the years 1939 and 1940, are substantially the same.

STATEMENT

The taxpayers are brothers who became partners in the waste material business about 1926. Sometime prior to December 27, 1937, the business was transferred to H. B. Hamburger & Company and each brother received one-half of the capital stock of that corporation. Louis Hamburger became president of the corporation and Samuel Hamburger became its secretary-treasurer. They continued to operate the business as before. (R. 87.)

On December 27, 1937, the brothers created the trusts here involved. Louis created five separate trusts, one each for his wife and four minor children (R. 87–88). Samuel created two separate trusts, one for his wife and one for his minor child. (Samuel subsequently created another trust for his newly born daughter, having reserved the right so to do in the declaration of trust.) (R. 88.) Each brother transferred all his capital stock in the corporation to his particular family trusts. The provisions of all the trusts were alike except for the names of the beneficiaries and the number of shares transferred. Each trust created by Louis named Samuel as trustee and each trust created by Samuel named Louis as trustee. Each trust was signed by both brothers in their capacities as settlors and trustees. (R. 88, 107.)

Each trust instrument contains the following provisions (R. 88–90):

1. Said Trustee shall have full and complete legal title to said stock, with full right to sell, exchange, mortgage, assign, encumber or otherwise dispose of the same, to the same extent that he could do if said Trustee was the full, legal and equitable owner thereof, and shall have full power to invest the proceeds of the sale thereof or dispose of any other property received in exchange therefor in any manner said Trustee sees fit, without any limitation or restriction whatsoever; said Trustee shall not be limited to making investments such as trustees are ordinarily limited to under the laws of the State of Michigan; that the powers of said Trustee shall include (without limiting the general powers above enumerated) the right to accept a proportionate share of the physical assets upon liquidation of H. B. Hamburger & Company, to use said assets in business either by himself or by entering into a partnership or association with others, to sell the same upon credit, to invest the proceeds thereof in notes of individuals or corporations, to loan money to individuals or corporations, to invest the income or the proceeds of the trust property in stocks, bonds, or any other securities of any nature or description in the sole discretion of said Trustee; that all of said powers shall apply equally to any other property coming into the hands of the Trustee by reason of being exchanged by said Trustee for the original trust property, and all of said powers

granted by this trust instrument to said Trustee shall apply equally to the principal of the trust property, any income therefrom, or any other property which may come into the possession of said Trustee under the powers given to said Trustee hereunder.

2. * * * that said Trustee shall have uncontrolled discretion in connection with the management, care, control and disposition of the said trust property, including any other property which comes into the control of the Trustee under the powers herein granted to said Trustee.

3. That the said Trustee shall, during the lifetime of Settlor, pay the net income to Settlor's wife [child], beneficiary hereunder, or other beneficiary named pursuant to and within the limitations hereinafter contained, or, instead of paying said net income in such manner may, in the sole discretion of said Trustee, accumulate such net income, which accumulations of income shall become part of the trust property, but said accumulations of income, less any net losses sustained prior to distribution, may be distributed by the Trustee in his sole discretion subsequently and prior to the termination of this trust to the then beneficiary or beneficiaries at the time such distribution is made. * * *

It is then provided that after the death of the settlor and until the termination of the trust certain minimum monthly payments shall be made to the beneficiaries (R. 90–91).

It is further provided (R. 91-93):

4. * * * None of the moneys paid to said beneficiaries by the said Trustee shall be used for the support and maintenance of such beneficiary if the then beneficiary at the time of such payment is a child or wife of the Settlor and at that time Settlor has any obligation to support or maintain said wife or child, or any other person for whom Settlor has any obligation of support or maintenance.

* * * * *

9. That the Settlor hereby expressly reserves the right from time to time during his lifetime, subject, however, to the limitations herein contained, by instrument in writing executed by Settlor and delivered to the Trustee or by appropriate provision in Settlor's last Will and Testament, to change the beneficiary or beneficiaries under this trust, to add a beneficiary, or to increase or decrease the beneficial interest of any beneficiary hereunder, including the right to name a charitable organization as a beneficiary or one of the beneficiaries hereunder; such right to change the beneficiary or beneficiaries may be waived and renounced at any time by the Settlor during his lifetime by written instrument executed by said Settlor and delivered to said trustee; provided, however, that the power reserved herein to change the beneficiary or beneficiaries is hereby expressly limited in that the Settlor shall have no power to

name himself or his estate as beneficiary hereunder.

10. That the Settlor or his estate shall not directly or indirectly become vested or revested with any legal or beneficial interest in the trust property or its proceeds, either of income or principal, nor shall any income, principal, or interest, beneficial or legal, in the trust property be held or accumulated for future distribution to the Settlor or to his estate, nor shall the same be distributed to Settlor or to his estate, nor shall any part of the principal, income, or proceeds of the trust property, or any part thereof, ever be applied to the payment of premiums upon policies of insurance upon the life of the Settlor, nor be used or applied for the support of the Settlor or for the benefit of Settlor or his estate, nor used to satisfy any obligation of the Settlor or his estate.

* * * * *

12. This trust shall continue until the death of the survivor of Louis Hamburger and Samuel Hamburger, and upon the death of the survivor of Louis Hamburger and Samuel Hamburger said trust shall immediately terminate and thereupon both the legal and the equitable title to the trust property, including undistributed accumulations, principal and income and any other property in said trust estate, shall immediately vest in the person or persons who at that time are beneficiary or bene-

> ficiaries under this trust, and if more than one person are at that time beneficiary, each shall take an undivided interest therein according to the respective shares which they held as such beneficiaries, and the Trustee or his successor, and all other persons claiming by, through, or under them, shall immediately confirm said title by transferring, assigning and paying over to such beneficiary all of the property, as above described in said trust estate.
>
> *   *   *   *   *
>
> 14. This trust is hereby declared to be irrevocable and there shall be no power to terminate, alter, or amend this trust instrument, nor shall there be any power on the part of anyone to revest in the Settlor or his estate any part of the corpus of the trust.

After the transfer of the shares to the trusts the remaining assets of each taxpayer consisted of a home, owned jointly with his wife, and life insurance policies amounting to some forty thousand dollars, which was not paid-up insurance. Neither taxpayer had any source of income other than the above-mentioned business. (R. 93.)

As contemplated at the time of the creation of the trusts, the taxpayers individually and as trustees made an agreement, dated December 27, 1938, to carry on the business as partners from and after December 30, 1938, under the firm names of H. B. Hamburger & Company and Production Steel Company, the partnership capital to

consist of all the property of the corporation. The assets were to be transferred by the corporation to the taxpayers, as trustees, pursuant to a plan of liquidation dated December 27, 1938. Louis' trusts were each to receive a 10 percent interest and Samuel's trusts each a $16\frac{2}{3}$ percent interest in the assets. (R. 93–94.) Under the partnership agreement the taxpayers, as trustees, agreed to transfer to the partnership all the assets received from the corporation (R. 94)—

> Provided, however, that so much of said property that consists of real estate or an interest in real estate may be retained in the name of Louis Hamburger and Samuel Hamburger individually but who shall hold the same in trust for the partnership under the terms hereof, this being done merely as a matter of convenience in order to avoid the creation of a cloud upon the title to such real estate and so as to keep the record title to said real estate marketable and to facilitate any future transfer that may be made for the purposes of partnership, the said first and second parties however hereby expressly agreeing that they will not make any transfers of said real estate or any interest therein, nor encumber the same in any way except for the purposes of the partnership and further acknowledge that they are holding said real estate and interest therein as trustees for the use and benefit of said partnership.

The partnership was to be actively managed by the taxpayers, and they were to receive no compensation other than 15 percent each of the profits. Each of Louis' trusts was entitled to seven percent of the profits and each of Samuel's trusts to 11⅔ percent. In the event of the liquidation of the partnership, the taxpayers were to have no right to participate in the distribution of capital except to the extent of their "share of profits and capital increase over and above the fair valuation of the capital at the time of the formation of the partnership over and above all liabilities, and only" to the extent of 15 percent each. The taxpayers agreed to give "the utmost of their skill and power" to the partnership and not to "carry on or be concerned or interested, directly or indirectly, in any other trade or business without the consent in writing of the other parties" to the partnership agreement. (R. 94–95.)

After the dissolution of the corporation, the business was conducted by the taxpayers as theretofore (R. 95).

Each trust had a separate bank account. Some of the partnership profits were paid to the trusts, as determined by the taxpayers. None of the income of any of the trusts was ever distributed to any of the beneficiaries. Samuel at times borrowed money from "the trusts," some of which he had repaid, but he now owes "the trusts" about $15,000 to $18,000. (R. 95.)

The corporation's earned surplus as of December 31, 1938, was $103,522.17 (R. 95).

Each taxpayer filed his 1937 income tax return on March 15, 1938, in which the only income reported by each was $17,500, salary received from H. B. Hamburger & Company. The $14,532.50 dividends received by Louis' five trusts and the $14,532.50 dividends received by Samuel's two trusts were omitted from gross income. Notice of deficiency in each return was mailed on May 25, 1942 (R. 95).

The Commissioner included in the taxpayers' individual income the income of the trusts established by them and assessed the following deficiencies (R. 87):

	1937	*1938*	*1939*	*1940*
Louis Hamburger____	$2, 526. 70	$14, 597. 91	$6, 919. 84	$12, 581. 70
Samuel Hamburger__	2, 591. 80	15, 014. 13	7, 068. 85	12, 941. 00

By stipulation the cases were consolidated for hearing and decision (R. 47–48, 105). The deficiencies were sustained by the Tax Court (R. 99) and the Circuit Court of Appeals for the Sixth Circuit affirmed (R. 121).

ARGUMENT

This case presents but another example of the use of the trust device for reallocation of income among the members of a family group. This Court has clearly enunciated the principles applicable in determining whether in such a situation a taxpayer's control over the trust property is the equivalent of ownership for tax purposes,

and whether the trust income is therefore taxable to him under Section 22 (a) of the Revenue Acts of 1936 and 1938, *supra*. *Helvering* v. *Clifford*, 309 U. S. 331; cf. *Harrison* v. *Schaffner*, 312 U. S. 579; *Helvering* v. *Horst*, 311 U. S. 112. This case is well within those principles, as the Tax Court and the circuit court of appeals both properly held.

1. The taxpayers seek to avoid the impact of the *Clifford* case by an assertion (Pet. 26) that the application of the decision rests on the presence of three essential factors, namely, a short term trust, reversion to the grantor, and retention of control over the trust properties. Here, taxpayers argue, the term of the trusts is not short, as in the *Clifford* case, but for "the longest period for which, under the applicable Michigan Statutes * * *, real property can be retained in trust" (Pet. 19); there is no reversion to the grantors and no power to provide by amendment for reversion (Pet. 20); and the powers of control are dissipated by the fact that the trustees are other than the grantors themselves, and exercise only "powers in trust" (Pet. 21).

We submit that the taxpayers' proposed rationale of the *Clifford* decision represents the very attitude rejected by this Court in that case when it declined "to let mere formalism obscure the normal consequences of family solidarity; and to force concepts of ownership to be fashioned out of legal niceties which may have little or no

significance in such household arrangements" (309 U. S. at 336–337). Taxpayers' mechanical analysis of the decision would disregard the Court's broad adjuration that "no one fact is normally decisive but that all considerations and circumstances of the kind we have mentioned are relevant to the question of ownership and are appropriate foundations for findings on that issue" (309 U. S. at 336).

The facts as established by the evidence and found by the Tax Court present no significant difference from those involved in the *Clifford* case. True, they vary therefrom in "the legal paraphernalia which inventive genius may construct as a refuge from surtaxes"; but this, as the Court admonished in the *Clifford* case, "should not obscure the basic issue" (309 U. S. at 334). The grantor is not the trustee; instead, the equal co-owners of a business each placed his half interest in trust for his own family, making the other trustee. After the creation of the trust, therefore, just as before, each controlled one-half of the business. Their powers were, as taxpayers point out, powers in trust; but this was no less so in the *Clifford* case. Moreover, as grantor, each retained decisive power over the distribution of the income from the trusts which he had created. Through his right at any time during his life or by will to change or add to the beneficiaries, and to vary the shares of existing beneficiaries, each retained substantially unalloyed power to channel

the proceeds of his own labors to such members of his family as he might choose—or, if he should choose, to outsiders. Each in his capacity as reciprocal trustee for the other's family had unleavened discretion to control the flow of income to the existing beneficiaries, even to the extent of withholding income altogether. Though neither could revest the property in himself or his estate, each nevertheless retained access to the property for his own personal needs, as is shown by the unrepaid borrowings of taxpayer Samuel Hamburger (R. 95). To quote again the language of the *Clifford* case (p. 335), "where the grantor is the trustee and the beneficiaries are members of his family group, special scrutiny of the arrangement is necessary lest what is in reality but one economic unit be multiplied into two or more by devices which, though valid under state law, are not conclusive as far as § 22 (a) is concerned." Here, the device selected is reciprocal trusteeships, arranged between brothers with identical and complementary business interests and similar familial aspirations. This device adds no more than complexity to the situation; it is totally ineffectual, we submit, to vitiate the conclusion of the trier of fact and of the circuit court of appeals that the trusts were nothing but a tax-saving device (R. 96, 121), and that the brothers remained the owners of the corpus for the purposes of Section 22 (a).

On principle, therefore, we believe that the decision below represents a proper application of the touchstone provided by the *Clifford* case. Nor is there any such conflict as the taxpayers seek to advance in support of their petition. Doubtless there is some lack of uniformity in the methods of statement employed by the various circuit courts of appeals in considering individual cases; and doubtless trusts bearing some of the features here presented have on occasion been held to fall outside Section 22 (a) for lack of other important features not found in the particular case. Such diversity is only natural in an area where the problem of the courts in each instance is to determine whether a particular factual pattern falls on one side or the other of a line, and where the variety of factual patterns, often enough constructed with an eye to tax avoidance, is virtually unlimited. But on the propositions urged by the taxpayers as basic in the application of the principles of the *Clifford* case, there is no conflict. Thus, no case is advanced in support of the proposition that the *Clifford* doctrine is limited to short-term trusts; and in fact the contrary has been held in numerous cases. *Helvering* v. *Stuart,* 317 U. S. 154; *Weil's Estate* v. *Commissioner,* 145 F. 2d 240 (C. C. A. 6), certiorari denied, 323 U. S. 793; *Commissioner* v. *Brown,* 122 F. 2d 800 (C. C. A. 3); *Brown* v. *Commissioner* (the same case at a later stage),

131 F. 2d 640 (C. C. A. 3), certiorari denied, 318 U. S. 767; *Commissioner* v. *Buck,* 120 F. 2d 775 (C. C. A. 2);[1] *White* v. *Higgins,* 116 F. 2d 312 (C. C. A. 1); *Foerderer* v. *Commissioner,* 141 F. 2d 53 (C. C. A. 3); *Williamson* v. *Commissioner,* 132 F 2d 489 (C. C. A. 7). No case is advanced as holding that a power to change beneficiaries at will must be disregarded as a factor merely because unexercised;[2] to the contrary, the significance of such a reserved power, even though unexercised, has been recognized in numerous instances. *Downie* v. *Commissioner,* 133 F. 2d 899 (C. C. A. 6); *Commissioner* v. *Brown, supra; Commissioner* v. *Buck, supra; Hyman* v. *Nunan,* 143 F. 2d 425 (C. C. A. 2). The cases of *Armstrong* v. *Commissioner,* 143 F. 2d 700 (C. C. A. 10), *Commissioner* v. *Branch,* 114 F. 2d 985 (C. C. A. 1), and *Commissioner* v. *Betts,*

[1] Whether or not, as taxpayers suggest (Pet. 27), this case "has been somewhat curtailed by a later decision in the same circuit"—*Phipps* v. *Commissioner,* 137 F. 2d 141 (C. C. A. 2)—we detect therein no recession which would be relevant here. The decision that the corpus in a long-term trust no longer belonged to the grantor for income tax purposes was rested on the fact that the allocation of the income among members of his family could not be controlled by the husband without a disregard of the purposes of the trust sufficiently flagrant in character to violate state law and to call for judicial correction.

[2] *Helvering* v. *Safe Deposit Co.,* 316 U. S. 56, cited at Pet. 11, 27, holding that property held merely subject to an unexercised general testamentary power of appointment is not includible in a decedent's estate under Section 302 (a) of the Revenue Act of 1926, is obviously irrelevant.

123 F. 2d 534 (C. C. A. 7), upon which taxpayers particularly rely (Pet. 9–10) for their claimed conflict, represent no cleavage of principle. In no one of them was the factual pattern significantly similar to that in the case at bar; in none was there so little change in the grantors' family economic situation, such continued dominion and control of the business constituting the trust assets. In none did the grantor retain the right to change the beneficiaries or to borrow freely from the trust funds. These cases do no more than illustrate the differing results which may be reached in applying the *Clifford* doctrine to differing states of fact. They furnish no occasion for the issuance of a writ of certiorari.

2. Taxpayers' references to the provisions of the Internal Revenue Code dealing with partnership income, and to cases decided under these provisions (Pet. 8–9, 31–34), are entirely beside the point.[3] This is not a situation "where the existence of a partnership has been ignored for tax purposes" (Pet. 31). The statutes and authorities relied on may be relevant to the division of partnership income between the individual taxpayers and the trusts; but no such question is involved here. This case deals only with the proper treatment of the income after, and to the

[3] If relevant at all, these provisions and cases would affect the result only for the years 1939 and 1940, since prior to these years the business was carried on in corporate form.

extent that, it has by recognized principles become income of the trusts. The inquiry is whether the taxpayers, not as business partners but as grantors and dominants of the trusts, are to be regarded as owners of the trust property for tax purposes. That question is, we believe, disposed of under the preceding point of this brief.

3. Taxpayers advance as an independent ground for certiorari the contention that the court below is in conflict with other circuits as to the effect of *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231, in cases involving application of the *Clifford* doctrine. We see no merit in this contention. It is not clear from the per curiam opinion of the court below whether that court regarded the question as one of law, on which it agreed with the Tax Court, or as one of fact, on which the Tax Court's decision was conclusive because supported by substantial evidence; but in either view the result below was correct. Substantial evidence sustained the Tax Court's findings, and it applied the correct principles of law. Its decision was properly affirmed. *Trust u/w of Bingham* v. *Commissioner,* No. 932, last Term, decided June 4, 1945. Cf. *Weil's Estate v. Commissioner,* 145 F. 2d 240 (C. C. A. 6).

CONCLUSION

The decision below was correct and the petition should be denied.

Respectfully submitted.

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